



**Small
Business
Finance
Corp**

Borrowers Guide

To Financing Business Owner-Occupied Real Estate
and Fixed Asset Equipment Through the SBA 504 Loan

2007 Edition

Prepared by

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A US Small Business Administration Certified Development Company Since 1981

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Introduction

Does your business plan call for buying real estate, for building or remodeling to support your expanding operations, or for purchasing durable fixed equipment?

Would you like to finance your expansion with as little as 10% down payment, keeping cash free for other business purposes?

Look Into an SBA 504 Loan

You've found the perfect building—the price and location is right, and with a little remodeling and the addition of a thousand square feet or so, it will be perfect to house your rapidly growing operation. But your banker says you need 25 or 30% down, tying up cash you'll need for working capital as you grow. Plus you still need to pay for the soft costs of your construction. Does this mean you have to abandon your plan?

Probably not. CEDCO-Small Business Finance Corporation, Colorado's statewide 504 Certified Development Company since 1981, can help you through the US Small Business Administration 504 loan program. In most cases an SBA 504 loan requires only 10%* down payment, and all project costs are included—land, building, renovation and soft costs. The loans are long term and provide a low fixed interest rate. And the SBA 504 loan program can finance the fixed machinery you need to buy.

- You often need only **10%* down payment**
- Lets you **keep more of your cash** for working capital during your expansion
- Long term -- low fixed interest rate: our rates are often the best available—through **2006** our twenty-year real estate loan has averaged **6.6%**. The rate is fixed from the month of funding until the twenty-year term.
- **Finance your soft costs** including accountant fees, title, insurance, attorney closing fees, etc.

***Please Note:** by regulation, for companies with less than two years of operating history or direct management experience 5% must be added to the down payment; for special purpose buildings such restaurants or convenience stores 5% down payment must also be added. For both special purpose and early stage companies we must add 10%.



The Role of the Certified Development Company

Certified Development Companies (CDCs) such as **Small Business Finance Corporation** are regional economic development organizations that are licensed by the U.S. Small Business Administration (SBA). Each CDC each has a geographic territory covering a state and sometimes counties in one or more adjacent state. We are licensed to make loans under the SBA 504 loan program to assist small businesses located anywhere in Colorado, as well as certain counties in New Mexico, Arizona and Utah. **Small Business Finance Corporation** processes, approves, closes and services the loans. Funding is arranged by **Small Business Finance Corporation** issuing a bond, and in all ways, **Small Business Finance Corporation** is the direct lender for the SBA 504 loan program.



Eligibility for SBA 504 Loans

You may be able to obtain SBA 504 financing if your business is:

- Organized as a **for-profit business**. The only not-for-profit companies eligible for SBA 504 loans are sheltered workshops.
- Legal entity-corporation, partnership, sole proprietor, Limited Liability Company.
- An LLC or other such entity may take title to the building and lease it back to the operating company; please contact us to obtain an SBA-approved example lease.
- **Any type of legitimate business**- manufacturing, wholesale, service, professional service or retail.
- Located in or planning to locate in any area of the United States.
- You must be a small business by the SBA's definition, namely either **net worth under \$7.5 million & net profits after taxes under \$2.5 million**, or meet SBA's other size standards (by sales or number of employees depending on NAICS code).
- Planning to use the loan proceeds for capital investment (land, building, leasehold improvements, renovation, construction, machinery & associated soft costs). The SBA 504 loan program is not a working capital program. See uses of loan proceeds section for more details.
- Another lender must be willing to participate in the financing. The SBA 504 loan finances up to 40% of the total project cost and the other lender finances 50%. The business or its owner typically puts in 10%, but may be asked or allowed to inject more. Economic development goals must be achieved through the project being financed.
- Owner-user of the project being financed (51% occupancy if existing building; 60% occupancy if new construction) Two or more unrelated small businesses may receive a 504 loan to buy or construct a building as long as they, together, will occupy at least 51% an existing building or 60% of new construction.

Companies that are **not** eligible for SBA 504 loans are: not-for-profit businesses (except sheltered workshops); businesses engaged in lending (such as banks, finance companies); passive holders of real estate and/or personal property; life insurance companies -- however an insurance agency is eligible;) businesses located in a foreign country or owned by aliens; businesses selling through a pyramid plan; illegal businesses; businesses which restrict patronage; government owned entities (excluding Native American Tribes); businesses engaged in promoting religion; consumer and marketing cooperatives (producer cooperatives are eligible); businesses engaged in loan packaging; businesses owned by persons of poor character; equity interest by lender, CDC or associates in applicant concern; businesses providing prurient sexual material; businesses that have previously defaulted on a Federal loan; businesses engaged in political or lobbying activities; and speculative businesses.

What are the Permitted Uses of 504 Loan Proceeds?

- Acquisition of vacant land
- Acquisition of land and building
- Leasehold improvements
- Renovation of building; addition to building
- Construction of a building
- Acquisition of a commercial fishing vessel or party boat
- Acquisition of heavy duty machinery & equipment (such as printing press)
- Associated soft costs: title searches & insurance; attorneys fees; appraisals; environmental reports; architects; permits; surveys; installation of machinery; points on bridge loans, small amount of furniture and fixtures, etc.
- *Not permitted* are mortgage broker fees; points on permanent financing; moving expenses.
- *Refinancing is not permitted except to take out financing on property acquired within last 9 months with interim funds.*



Economic Development Requirements

SBA 504 is a community lending program designed to improve the locality. Eligibility requires that the borrower fulfill one of these three types of goals:

1) Job creation or retention

One job per every \$50,000 borrowed from **Small Business Finance Corporation** under SBA 504)

Or...

2) One Public Policy Goal:

- Revitalize a business district of a community with a written revitalization or development plan
- Expand exports
- Expand a woman-owned (51%) business development
- Expand a veteran-owned (51%) business development
- Expand a minority-owned (51%) business development
- Change necessitated by federal budget cutbacks
- Change required by mandated standard re health, safety, environment
- Increase productivity & competitiveness (retooling, robotics, or modernization)

Or...

3) One Community Development Goal:

- Help to improve, diversify or stabilize the economy of the locality
- Stimulate other business development in the community
- Bring new income into the community
- Assist manufacturing firms
- Assist businesses in a labor surplus area.

SBA 504 is not a real estate investment tool. It exists to help the community by helping small business have an impact on the community-by creating jobs or in other ways benefiting the community.



Deal Structure -- Financing

- You determine the total project cost (hard and soft costs).
- A bank or other financial institution finances 50% of the cost and takes a first mortgage (lien) position on the assets financed.
- Small Business Finance Corp., through the SBA 504 loan, finances 40%, 35%, or 30% of the project cost and takes a second mortgage position. (We can provide a smaller percentage of the project financing on larger projects, such as loan of \$1,500,000 comprising 25% of a \$6,000,000 project).
- You invest as little as 10% equity.

Typical Project:

<u>Use of Funds</u>	<u>Amount</u>
Purchase Building and Land	\$1,000,000
Renovate and Expand	\$200,000
Install New Equipment	\$75,000
Soft Costs (Appraisal, Environmental, Etc.)	\$5,000
Total Project Costs	\$1,280,000

<u>Source of Funds</u>	<u>% of project</u>	<u>Terms</u>	<u>Amount</u>
Small Business Finance Corp.	40%	20 years, fixed rate, 6.5% in Oct 2006	\$512,000
Bank or other lender	50%	Their rate and term, at least 15 years, usually variable rate	\$640,000
Business owner investment	10%	Cash, project land, or subordinate financing	\$128,000
Total Project Costs	100%		\$1,280,000

Please note:

- The seller can provide the 50% permanent financing but, under current regulations, the seller must be co-equal to or subordinate to the SBA 504 loan.
- The 50% financing can come from a variety of nonfederal sources such as banks, non-bank institutions, and government agencies.



Amount of Financing Available per Borrower

Small Business Finance Corporation can lend you up to 40% of the project cost with a dollar cap of **\$1,500,000** per borrower. This amount can be applied to several loan requests for different projects.

Small Business Finance Corporation can exceed **\$1,500,000** and lend up to **\$2,000,000** of SBA 504 financing per borrower if:

- The project will help revitalize a business community with a written revitalization plan, or
- The project will help your company to expand its exporting, or
- Your company is 51% or more minority, woman or veteran owned, or
- Your business in a rural area (by USDA or Census definition), or
- The project will increase productivity and competitiveness by retooling, modernization or assistance in competing with imports, or
- Your business was affected by federal budget cutbacks (such as defense downsizing).

If you are a manufacturer (by certain NAIC codes) we can lend up to \$4,000,000 for our portion of financing!

Advantages of SBA 504 over Conventional Financing

Low down payment—most often just 10%. This lets you preserve your cash for your working capital. Most banks will lend only 60-70% of the appraised value of the project leaving you to sink in 30-40% plus the cost of renovations plus the soft costs.

Fixed rate on the SBA 504 portion-- You don't have to worry about the prime lending rate going up. You can plan because you know the amount of your mortgage payments for the next 20 years.

Long term. CDC 504 loans are for 10 or 20 years. Because **Small Business Finance Corporation** is in second lien position, the bank or other lender doing the 50% first lien loan are willing to lend at a longer term. Longer terms make your monthly payments lower.

Low interest rate. Even with all the fees and closing costs included in the rate, it is still a low rate for a subordinate mortgage loan, particularly for small business. The blended rate as between the bank portion and **Small Business Finance Corporation's** 504 portion makes the project affordable for you.



Rates and Terms

The rate on the SBA 504 portion of your project is set when **Small Business Finance Corporation** sells a **bond** to fund your loan; the rate is then fixed for the loan term. 504 bonds are amortized securities, typically purchase by large investors such as retirement funds. Your loan will actually be consolidated with numerous other loans from around the country, and portions of that whole "pie" are sold as bonds. For comparable rates, look at treasury rates. The SBA 504 rates have historically been at or below conventional loan rates, with the added appeal of being fixed for their twenty year term. The effective rate (APR) will include program fees and a loan loss subsidy.

For our latest rate, please contact you Small Business Finance Corporation loan officer.

Loans have ten year repayment terms for equipment, or twenty years for real estate (or real estate plus equipment); al loans are “self liquidating”.

In order for **Small Business Finance Corporation** to make a 20-year loan, the lender providing the 50% permanent first mortgage must have at least a ten-year term, and may have a longer repayment. Typically, lenders will lend with a 15-20 year term and 20-year payout.

For **Small Business Finance Corporation** to make a ten-year loan, the 50% lender must have a term of at least 7 years. Again, most first mortgage lenders will match CEDCO’s ten-year term.

Principals (Owners)

- Owners must be US citizens or registered aliens with green card.
- Owners cannot be convicted felons currently on probation.
- Anyone who owns 20% or more of the operating company must personally guarantee (unsecured general guarantee).

Liquid assets of the principals are taken into account in determining eligibility. Too much liquid assets owned by a principal could disqualify the loan because it will be deemed that the project could be financed by the principal without SBA 504 assistance.



Collateral

Small Business Finance Corporation takes a subordinate (second mortgage) to secure its 30-40% portion of the financing, and **Small Business Finance Corporation** takes a security interest in assets financed. Key personnel life insurance is generally not required unless there is no succession of management. Other assets of the business or principals are generally not required, unless the company is a startup or the credit is unusually risky or the asset being financed is considered a single purpose asset or doesn't appraise high enough. In this case additional collateral in the form of a security interest in business or personal property may be needed to make loan approval possible.

Fees and Payments

All of the fees on the SBA 504 loan are added to the loan amount so that you can amortize their cost over the loan term. You will sign a note for the **Small Business Finance Corporation** portion (30%, 35%, or 40%) of project cost plus the fees.

- Fees are based on the **Small Business Finance Corporation** portion of project cost;
- 1.5% of the **Small Business Finance Corporation** portion is paid to us as our processing fee;
- 0.5% of the Small Business Finance Corporation portion is a reserve deposit for the SBA;
- 1/4 of 1% of the loan amount is a funding fee;

Closing Costs—Various closing costs will be included—an amount for CEDCO's title insurance and recording fees can be added to the loan if the appraisal on the property supports this.

Servicing Fees— In addition, when the loan closes, your monthly payment will include servicing fees based on the declining balance of the SBA 504 loan:

- 5/8% to Small Business Finance Corporation;
- 1/8% to SBA;
- 1/10% to central servicing agent (Colson Services).

All of these amounts have already been figured into the interest rate set at the time the 504 loan closes. Our average loan rate for 2006 was about 6.5%, including these fees.

Payments on the SBA 504 loan are made by ACH debit to the borrowers designated checking account on the first of each month after the loan closes. Payments on the 504 loan are separate from your payments on the 50% first mortgage loan.



More About Down Payments, Prepayment Penalties, and Interim Financing

Down Payments—If the operating company has been in business for less than two year, or if single purpose buildings are financed, 5% is added to the equity injection required. If both of these are true, 10% is added:

	Most often	If less than 2 years in business ("New")	If "Special Purpose" building	Both "Special" and "New"
Borrower Investment	10%	15%	15%	20%
Bank Loan	50%	50%	50%	50%
SBA 504 Loan	40%	35%	35%	30%

Prepayment Penalties—There is a prepayment penalty for the first half of the loan term on the SBA 504 loan. This penalty is in place because a bondholder purchased the bond funding each loan with an expectation of regular repayment at a regular rate of return, so only regular monthly payments are permitted for the 50r4 portion of financing.

If you pay off the loan in the first half of its term (ten years for twenty-year loans; five years for ten-year loans), you will be assessed a penalty. This penalty is approximately equal to the funding rate of the note before the addition of fees if the loan is repaid in the first year, and the penalty diminishes by ten percent for each year up to the end of year ten, or twenty percent for five years for a ten-year loan. And exact schedule of the prepayment penalty is provided at the time the loan is funded, and your **Small Business Finance Corporation** loan officer can provide an estimate during loan processing.

Interim Financing—**Small Business Finance Corporation** is a permanent lender only. This means the 50% first mortgage lender will have to bridge CEDCO's 504 loan portion until the project is complete. **Small Business Finance Corporation** will sell its bond and fund its loan when a certificate of occupancy ("C-O") is issued. Interest and fees on the interim loan can usually be included in the project costs to be financed.



The Loan Process

Here's a step-by-step description of the typical loan process:

1. Call **Small Business Finance Corporation** and talk to a loan officer to discuss your project.
2. Talk to your bank to see if the bank wants to participate by doing the permanent first mortgage and bridge loan.
3. Meet with **Small Business Finance Corporation's** loan officer and structure the deal. Most often this is a collaborative effort with your bank, and either we or the bank can take the lead in managing the financing, as you wish.
4. Submit the **Small Business Finance Corporation** application, which consists basically of the same materials you will submit to your bank. Basic application materials include:
 - 2 years of financial statements and federal tax returns on the company (if in existence for 3 years);
 - If there is no historical cash flow ability to service the proposed new debt, submit 2 years financial projections;
 - Personal financial statement (assets and liabilities) on the owners of the company and most recent 2 year's tax return;
 - A brief written history of the business, reasons for expansion, plans;
 - Copy of contract of sale and cost documentation of any improvements or construction;
 - Personal history statement (SBA Form 912) of principals indicating citizenship status, etc.
5. Our loan officer and other people on our staff will get to know and evaluate you and your company. **Small Business Finance Corporation** will draw credit reports; makes supplier, bank and trade checks; visit your existing and proposed operations/facilities; assess your credit ability and character.
6. Either before or after your bank or other first lien lender has indicated an interest in financing their 50% portion of the project.



7. **Small Business Finance Corporation** staff prepares a credit memorandum and presents it to our Board, which serves as our loan committee—they meet once per month. If your project requires faster attention, we'll convene an “electronic” meeting of the Loan Committee by phone and email.
8. Once the board approves the project and the bank approves, too, **Small Business Finance Corporation** presents the application to the SBA to acquire its guarantee for **Small Business Finance Corporation's** bond. This generally takes 3-5 business days.
9. **Small Business Finance Corporation** then issues a commitment and your bank closes its first mortgage loan and bridge loan. You use the bank's funds to complete the project.
10. When the project is complete, you close with **Small Business Finance Corporation** and the SBA, acting through Colson Services, an intermediary, wires its money to the interim lender
11. You make two loan payments each month, one to the bank, and the other for the SBA 504 loan, which comes as a direct fund transfer from a bank account that you specify.
12. **Small Business Finance Corporation** services the loan until it is repaid in full.



What Happens When You Close— Plus More About Costs & Fees

What should you do to prepare for your closing, and what will be expected of you afterwards? What will closing cost, and how and when must it be paid? Of the many responsibilities detailed in the “Debtenture Authorization”, which ones are yours, and which are ours? What if you want to prepay your loan? Answers to these and other questions follow below, or may be obtained from CEDCO’s expert staff:

CLOSING

1. **Closing Expenses:** Closing expenses are due at time of closing and are collectable at time of loan funding. They are comprised of the following:
 - Legal costs for the preparation of documents, the review of borrowing entities, the review of title and lending, the preparation of the Certification Letter required by SBA’s *Authorization for Debtenture Guarantee*, and the legal assistant cost. (Approximately \$1,000 to \$2,500.)
 - Title Insurance Costs
 - Filing and Search Fees
 - CEDCO’s expense for photocopies, travel and lodging, phone and express delivery as applicable
2. **Real Estate Taxes:** CEDCO may in some cases, by pre-arrangement with the borrower, collect and reserve funds for real estate taxes for payment when due. At the time of closing, CEDCO must have documentation that the previous year’s taxes were paid and that there is a reserve for the currently incurred taxes.
3. **Hazard Insurance:** Hazard insurance on the Project Property must be obtained prior to closing and must be current. The amount should be the full replacement cost and must contain a mortgagee clause in favor of the SBA and CEDCO. The policy must provide for 10 days notice prior to cancellation
4. **Current Financial Statement:** A Balance Sheet and Profit-and-Loss Statement on the operating business, no more than 60 days old, will be required at the time of closing.



5. **Life Insurance Assignment (if required):** Policy must already have been issued and provided to CEDCO prior to closing,
6. **W-9:** An IRS Form W-9 must be completed and submitted with every package. Relevant tax reporting information will be reported by the Central Servicing Agent to the person or entity identified on this Form. The Borrower must select one person or entity and insert all applicable information.
7. **Method of Loan Payment:** Loan payment for the SBA 504 loan is made by automatic debit, beginning on the first business day of the month following the sale of the bond which funds the loan. Please set up such an account before the loan closes and provide us with ACH (automated debit) information when the loan closes.
8. **Timing:** The SBA 504 loan is funded by selling a Government Guaranteed Bond in New York City. All of the requirements of the SBA *Authorization for Debenture Guarantee* must be met before acceptance by SBA for presenting to the Bond Market. Each loan is dated for a certain bond sale which takes place once a month. The collateral documents, Deed of Trust, Financing Statements, must be documented of record. As the documentation of these recordings can take from 2 to 4 weeks, a loan closing needs to take place six weeks or more before funding.
9. **Title Insurance**
 - Title must be unencumbered, except for interim lending, at time of closing the 504 loan.
 - Improvement Location Survey, as completed, is required on new construction.
 - Mechanics and Materialmen's lien insurance is required on policy. All bills must be paid and lien waivers acquired.

AFTER CLOSING

1. **Expectations of Borrower:** During the term of your loan, certain requirements need to be met in addition to payment of the loan on schedule and maintaining the value of collateral. These are in the Loan Agreement, the Note or the Servicing Agent Agreement. Certain of these include:
 - Provide CEDCO with annual, year-end Financial Statements.



- Provide prompt notification of any adverse change in the worth or profit of the business.
 - Provide written notice of any proposed change in the ownership of the business or the type of business.
 - Maintain Hazard Insurance on the property and provide CEDCO with proof of Insurance.
 - If previously arranged with CEDCO, deposit Real Estate Taxes with CEDCO in monthly or quarterly payments and provide the tax bill for payment as soon as you receive it. A schedule will be prepared for the year; monthly statements will not be sent.
- 2. Sale of Assets:** If you decide to sell the assets that are the collateral for the loan (i.e., land, building, equipment, furniture and fixtures, etc.), you must give CEDCO no less than 45 days notice, in writing.
- 3. Prepayment of the loan**
- The repurchase premium (prepayment penalty) is defined in the debenture, a copy of which is enclosed with your note, completed after funding.
 - Deposit \$1,000 (non-refundable).
 - Written notice, 45 days prior to prepayment.
- 4. Assumption of the loan**
- Information on the new borrower and copy of contract is required.
 - You may or may not be released from obligation as guarantor.
 - There will be an assumption fee from the buyer.
 - Written notice, 45 days prior to assumption.
- 5. If you sell the business and retain the assets**
- The lease between you and the new business must be assigned to the SBA.
 - Financing statements filed with the Secretary of State must be amended for the new owner's name.
 - Information on the new borrower and copy of contract is required.